HELP ?

Securing the benefits of trade and investment

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Abstract:
*Developments in technology, communications and trade mean that the world is becoming a global village. The volume of merchandise trade is now 16 times larger than in 1950, and outflows of **foreign direct investment** have grown even faster than trade in recent years. Trade and **investment** have been major engines of prosperity in developed and developing countries alike and have been a potent and efficient means of diffusing technology world-wide. In the process everyone has had the chance to reap the **benefits** of globalization.*

Full Text:

[Headnote]

Developments in technology, communications and trade mean that the world is becoming a global village. The volume of merchandise trade is now 16 times larger than in 1950, and outflows of foreign direct investment have grown even faster than trade in recent ,ears. Trade and investment have been major engines of prosperity in developed and developing countries alike and have been a potent and efficient means of diffusing technology world-wide. In the process everyone has had the chance to reap the benefits of globalisation.

In the last half-century, world prosperity has risen many times over, with economic growth being sustained at a rapid pace. As long IS current trends in technology, investment and trade continue, one can indeed talk of the dawn ning of a new global age. BLut to attain the benefits that it will bring. it is vital that the opening of trade and investment continue and that there he no backsliding as protectionist sectional interests ask for exemption from these globally beneficial trends.

Market integration induced by trade and investment has led to deeper forms of economic interdependence among nations and a growing number of developing and former centrally planned economies have become more closely tied into the global economy. Developing countries rely on OECD countries for more than 60% of their trade. Trade and investment between developing countries are also on the rise, as more than a third of their exports now go to each other.

This integration brought on by trade and investment is the basis of current prosperity and underpins rising living standards. But just as it drives improvements in productivity, such expansion can cause dislocation, impose adjustment on domestic economies and increase the vulnerability of economies to external shocks. Adjusting to the shocks requires that markets function effectively. The OECD has a role to play in this regard in the development of a global architecture that will let markets function better. to the benefit of everyone. Examples include OECD work on combating bribery and corruption, multilateral rules for investment, export credits, taxation and the Jobs Strategy which has stressed the importance of adaptability.

Last year, OECD Ministers asked us to prepare a study of the benefits of trade and investment liberalisation. It is just about to he published.

Support for liberalisation may have weakened economy that in recent years because of concerns about jobs. wages and the environment, Addressing these concerns requires attention to weaknesses in both communications and policy:

* the communications weakness represents a failure on the part of the proponents of open markets to explain clearly what trade and investment can and cannot do and what liberalisation is and is not responsible for

* the policy weakness represents a failure by governments to introduce the measures necessary to help citizens and communities take advantage of the on-going, unprecedented, technology-driven transformation of OECD economies.

Trade and investment play a part, but only a part. in this transformation. The technological change and the displacement of the unskilled which it often entails play a prominent role. Indeed, most of the displacement which has occurred can be related more closely to new technologies than to growing trade and investment.

However, to secure the benefits of trade and investment liberalisation, it is not sufficient to point to incontrovertible evidence that liberalisation creates wealth. It is also necessary to confront the legitimate worries of citizens who are adversely affected.

Integration and Prosperity

The case for open markets rests on a simple, long-standing premise. When individuals and companies engage in specialisation and exchange, the nation will exploit its comparative advantage by using its natural, human, industrial and financial resources to do what it does best. The result is growing prosperity and a wider choice for consumers.

In spite of the clear net benefits generated, and the evidence that open trade produces more winners than losers, the very fact that there are some losers leads to periodic calls to protect industries and workers against cheap imports and against change. Societies pay a high price for heeding such calls. Protection rarely tackles the underlying necessity of adjustment, efficiency gains and competitiveness. It encourages firms to engage in costly and wasteful lobbying and promotes inefficiency and further dependence on protection.

The case for open markets is as compelling for investment as it is for trade. Foreign direct investment creates clear net benefits for host and source countries alike. More open economies enjoy higher rates of private investment, which is a major determinant of economic growth. Although there is little disagreement over the benefits of inward investment, as evidenced by the fierce global competition to attract it, the effects of outflows of direct investment, particularly on employment, are still regarded with some disquiet.

The evidence on outward investment suggests that these fears are not justified. By enabling firms to remain competitive, outward investment supports employment at home. Moreover, 60% of total foreign direct investment is in services, where a local presence is necessary in order to compete. Investment abroad creates secondary flows - exports of machinery and other capital goods, for example - and increases demand for manufactured intermediary products and the provision of expertise and specialised services. Recent work on a sample of 14 OECD countries found that each dollar of outward foreign direct investment was associated with up to $2 of additional exports.

Expanded Trade with Developing Countries

Since the 1970s there has been an increase in the share of developing-country trade with OECD countries and, in parallel, mounting concern over unemployment and earnings differentials in the OECD area. The coincidence of these trends has led many to view competition with low-wage, low-labour-standard developing countries as having much to do with the sharp decline in the demand for unskilled labour and the related rise in income inequality observed in some OECD countries.

Studies of this issue agree that increased imports from developing countries do place downward pressure on the wages of industrialised country workers. but most characterise such impacts as modest. Other factors, such as technological change, are also at play. Trade and investment are held responsible for a much bigger impact on wages than the facts warrant. This misapprehension creates a two-fold risk: first, that of assigning the wrong policy instrument to legitimate social and economic policy concerns; second. that of making matters worse by failing to address their root causes.

One has to look to manufacturing to gauge the significance of the potential threat posed by trade with developing countries. The share of manufacturing in OECD employment has seen a decline from 31% in 1960 to 19% in 1996. Yet this decline reflects a natural evolution in the structure of advanced economies. Moreover, the reality is that industrialised countries primarily trade manufactured goods with one another.

Imports of manufactured products from emerging economies have indeed grown steadily during the past three decades, but they still represented a mere 1.6% of OECD countries combined output in 1994. Furthermore, total trade in manufactures between OECD countries and emerging economies is broadly in balance, a situation that has changed little since the late 1960s.

What about foreign investment? The claim is often heard that outflows of capital from advanced countries have lowered wages, as multinational firms expand or establish overseas affiliates in order to export back to the parent company in the home country. The evidence argues otherwise. Most outflows of investment from OECD countries go to other OECD countries, and those developing countries which receive substantial amounts of inward investment tend to be among the richest economies in the developing world. One reason that low wages do not have the expected allure for foreign investors is because they almost always and everywhere reflect low productivity. Differences in the cost of labour required for a unit of production, where they exist, are much smaller than wage differentials.

A Wide-ranging Adjustment Strategy

Trade, investment and technology interact in ways that raise the wages of high-skilled workers and depress the demand for the low-skilled. The message that open markets lead to gains in aggregate welfare is of little consolation to people whose lives may be adversely affected by change and who may have to uproot their families in search of alternative employment. Nor does the message sit well with displaced workers whose new jobs may pay lower wages.

But postponing adjustment through trade protection or restrictions on capital outflows has been amply shown by theory, history and empirical evidence to be a blind alley. Protection insulates economies from the market signals that point to the importance of early adjustment, inflict damage on the most dynamic firms and most productive workers in society, and provide what is in most instances a short-term and high-cost palliative to firms, workers and communities for whom delayed adjustment almost invariably translates into worse longer-term hardship.

There is a better way. Labour-market policies that provide adequate income security. by facilitating the re-employment of displaced workers in expanding firms and sectors. can produce important equity and efficiency gains. More fundamentally, governments have to work on the whole range of policies - such as education, training, taxation, pension reform and the portability of health benefits (where that is an issue) - that can help citizens and communities to adjust not only to market-opening but to technology-driven change as well. With the proper mix of policies, governments can maximise the benefits and minimise the costs of liberalisation of trade and investment.

Over the past few years public concern has grown over the possibility that trade and investment may encourage the exploitation of workers in developing countries and lead to unacceptable pressure on the environment. So far as labour standards go, the main policy message emerging from work at the OECD and elsewhere is that developed countries should not regard low core-standards for labour as a substantial competitive factor in their trade with low-wage developing countries. A second message is that, far from being part of the problem, market liberalisation is part of the solution to low labour standards which, above all else, are rooted in poverty. The same arguments can he made about the environmental impact of the liberalisation of trade and investment.

The concerns raised bv the environmental community stem from two main sources. The first is the fear that globalisation is stepping up pressures to relax existing environmental laws and regulations and that it is an obstacle to raising those standards. The second is that economic growth is itself a threat to the environment.

There is little evidence to support the first concern. In fact, the pressure is more likely to operate in the opposite direction. Openness to trade and investment translates into increased pressure for more stringent environmental standards arising from the drive to sell into markets with higher standards and greener` consumers. It also reflects the fact that multinational firms increasingly adopt world-wide standards for environmental performance. Moreover, experience suggests that as the developing countries grow richer. their demand for a better environment will grow as they acquire the means to satisfy it.

The concern over economic growth itself as a source of environmental pressure has an element of truth, but misses the key point Although it is true that liberalisation of trade and investment aids the environment by making the best use of scarce resources facilitating the transfer of technology and generating increased revenues to pay for cleaning-up the environment. liberalisation can also lead to more pollution and depletion of natural resources. But in most cases, environmental probIems can he traced to the inability of the market to put a proper price on the use of environmental resources and to reflect such costs in the prices of goods and services that people and companies consume.

The main policy conclusion to be drawn is that liberal trade and investment policies and more efficient environmental policies, based on economic instruments that use price signals to guide behaviour, complement each other. Rather than foregoing the benefits of trade and investment liberalisation, progress must be made in putting in place policies that value environmental resources correctly. This task deserves high priority on national and international agendas.

The Multilateral Agreement on Investment

Negotiations are unde\vay at the OECD to develop a Multilateral Agreement on Investment (MAI).

What are the aims of the MAI? Although markets are the main determinant of investment decisions, the investment climate is also a major factor. Investment implies entrepreneurship and risk-taking, so investors require transparency and long-term stability of rules and procedures. They seek open markets and competitive opportunities elsewhere ris-a-ris domestic investors through ensuring the same treatment for foreign as domestic investment and protection for existing ones. In pursuing agreements like the MAI, governments seek to enhance stability and reduce the risks by engaging their sovereignty to establish rules for international commerce. This is what the MAI aims to do. and it is the raison d'etre of international institutions like the OECD, the IMF, the World Bank and the WTO.

To date, international co-operation has relied mainly on a growing network of bilateral investment treaties, on regional undertakings and on the existing investment instruments of the OECD. The MAI will substitute comprehensive investment rules, incorporate high standards for the liberalisation of investment regimes and offer protection to investors and their investments. It will also provide an enforceable mechanism for settling investment disputes between states and between investors and states. OECD countries' interest in the MAI reflects their dual role as hosts and recipients of foreign direct investment.

Trade and investment agreements do not seek to direct or curtail the objectives of other national policies or regulations. That this is so is apparent from the fact that OECD countries exhibit a striking diversity of economic and social policies and regulatory frameworks. Tax rates, minimum wages, wage-bargaining systems, building standards, retail and distribution systems and social-security systems, to mention only a few examples, var widely. Thus there is compelling evidence that market liberalisation is compatible with a wide range of economic, social and political preferences The MAI will not allow foreign investors to stand immune from the host country's regulatory framework. It aims to achieve a situation where foreign investors are not discriminated against, but they are still subject to the same substantive laws and regulations that apply to domestic investors.

There is concern among some citizens that trade and investment liberalisation is somehow drawing societies into a ruinous race to the bottom that will undermine national regulations. The core message of work at the OECD is that these concerns are unfounded. Proponents of market opening have to devote more time and effort to disseminating this message. Efforts must also be made to explain how anxiety over adverse developments in the labour market, particularly for unskilled workers, or over instances of environmental degradation, will be compounded by protectionist responses. Such issues are typically best addressed through other instruments than trade and investment policies.

The liberalisation debate is a debate over ideas and ideals, and it matters enormously that we spread the message that market liberalisation forms part of the answer to the concerns of citizens, rather than being a cause of their misgivings.

Liberal trade and investment policies are not only about more choice but also about fairness in ensuring that the general interest - concern for the welfare of all citizens - prevails over special interests; and in seeing to it that the dividends of liberalisation are distributed more widely.

[Author note]

Donald J. Johnston, Secretary-General of the OECD